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No. 84-129

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

IN RE FLIGHT TRANSPORTATION
CORPORATION SECURITIES LITIGATION

REAVIS & MCGRATH, A PARTNERSHIP,

Petitioner,

v.

FRANK P. ANTINORE, ET AL.,

Respondents.

RESPONSIVE BRIEF TO PETITION FOR A WRIT
OF CERTIORARI TO THE UNITED STATES COURT
OF APPEALS FOR THE EIGHTH CIRCUIT

AND

CROSS-PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED

I. Whether certain claimants against a bankruptcy estate can be excluded from equal participation in the estate by means of an agreement entered into by the estate that excludes such claimants and that transfers all the assets of the estate to the control of other claimants.

II. Whether an agreement entered into by a Chapter 11 bankruptcy estate transferring all its assets and control over all its assets to third parties constitutes a *de facto* plan of reorganization, requiring compliance with the provisions relating to plans of reorganization.

III. Whether the district court can approve a settlement in a multi-district class action and bankruptcy proceeding without preparing findings of fact, conclusions of law, or any opinion explaining its decision.

STATEMENT REQUIRED BY RULE 21(b)

The proceedings in the court below involved the claims of cross-petitioners/respondents (appellants below) Russell T. Lund, Jr., Wardwell M. Montgomery, Delbert Oldenburg, Marjorie Terhaar, Larry Walston, Walston Wings, Inc., Lunds Inc., and Edward Brunner. The proceeding in the court below also involved the claims of petitioner Reavis & McGrath and respondents Frank P. Antinore, Sid Bader, Dennis Barr, Caroline J. Bender, Barry Bernstein, Dolores and Robert Bezark, James P. Christopher, Sylvester E. Daily, Jr., Ethel Dimicele, James J. Donohue, Ron Fingerhut, Kristi A. Fogarty, Robert L. Gold, Andrew Goodman, Emil Gotschlich, Theodore Herman, Joyce Hill, Ronald Knuth, Dennis A. Koltun, Stanley F. Koutek, Milt Krelitz, Carmen and Eugene Kreuzkemper, Grant Lovelle, James Lovelle, Joseph Mangano, Donald Miller, Phyllis Miller, Gordon Moscoe, Dennis Rease, Phil Richter, Maureen Schleiffer, Richard Schwartzchild, Ann Seaver, Bruce Shankman, Ellyn and Robert Stein, Marvin Steinberg, James Walsh, Allan Ziskin, Putnam High Yield Trust, United High Income Fund, Inc., and Oppenheimer High Yield Fund. The other parties in the court below were Drexel Burnham Lambert Incorporated, Moseley, Hallgarten, Estabrook & Weeden, Inc., Greyhound Leasing and Financial Corp., Continental National Bank & Trust Co. of Chicago, Norwest Bank Minneapolis, N.A., Norwest Bank Calhoun-Isles, N.A., the receiver of Flight Transportation Corp. and its subsidiaries, and Fox & Company, and Jack Adams, Jr.

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Cross-Petitioners/Respondents Ezell Jones, Russell T. Lund, Jr., Wardwell M. Montgomery, Delbert Oldenburg, Marjorie Terhaar, Larry Walston, Walston Wings, Inc., Lunds Inc. and Edward Brunner respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case. Cross-Petitioners also respond hereby to the petition for a writ of certiorari filed by Reavis & McGrath, supporting the granting of a writ with respect to Questions 1 and 3 presented by Reavis & McGrath, and opposing the granting of a writ with respect to Question 2 presented by Reavis & McGrath.

OPINIONS BELOW

The Eighth Circuit's opinion is reported at 730 F.2d 1128 and is set forth in Appendix A of Reavis & McGrath petition. The Eighth Circuit's denial of rehearing en banc is not reported and is set forth in Appendix B of Reavis & McGrath's petition. The district court's orders are not reported and are set forth in Appendices C, D, and E of Reavis & McGrath's petition.

JURISDICTION

On March 26, 1984, the Eighth Circuit entered judgment. On May 25, 1984, the Eighth Circuit denied Reavis & McGrath's petition for rehearing and suggestion of rehearing en banc. The jurisdiction of this court is involved under 28 U.S.C. § 1254(1).

This cross-petition and response is filed pursuant to extensions of time granted by the Clerk of the Supreme Court on August 13 and August 14, 1984, by letters to Lowell E. Sachnoff, Esq., and James R. Safely, Esq. and pursuant to Rule 19.5. In such letter the Clerk extended the time for all respondents to file responses to and including October 8, 1984. Cross-petitioners respectfully request that this cross-petition be considered irrespective of the disposition of the Reavis & McGrath petition.

STATUTES INVOLVED

The relevant provisions of the Bankruptcy Act and Bankruptcy Reform Act of 1978, 11 U.S.C. § 101 et esq., are set forth in Appendix F of Reavis & McGrath's petition.

STATEMENT OF THE CASE

Flight Transportation Corporation ("FTC") sold common stock in a public offering in 1979 for approximately $1.6 million. In March 1981 and June 1982 it sold approximately

$7.2 million and $25.6 million of additional securities, respectively.

On June 18, 1982, a few days after the closings of the 1982 offerings, the Securities and Exchange Commission (the "SEC") commenced an injunctive action against FTC and its subsidiaries and against William Rubin, its president, alleging *inter alia* violations of the antifraud provisions of the securities laws. FTC was placed in receivership and trading in FTC securities was stopped.

Many private actions quickly followed, including actions on behalf of purchasers of FTC securities and actions by creditors of FTC. All individual cross-petitioners except Brunner were directors of FTC ("Outside Directors") and thus were named as defendants in various of these lawsuits. Outside Directors have asserted claims against FTC, its president and others for indemnity. Cross-petitioners Lund, Lunds Inc., Montgomery, Walston Wings, Inc., Walston and Brunner were themselves defrauded of millions of dollars in the aggregate and have also commenced actions against FTC, its president and others.

An involuntary bankruptcy petition was filed against FTC June 29, 1982, under Chapter 11 of the Bankruptcy Reform Act. On May 18, 1983, the bankruptcy court directed that FTC be declared a bankrupt, and subsequently the FTC Receiver was appointed as the debtor-in-possession of FTC.

As of April 15, 1983, the FTC Receiver, three creditors of FTC, and attorneys for plaintiff classes of security purchasers entered into a "Sharing Agreement." The Sharing Agreement provides that all parties thereto shall pool their claims relating to FTC and transfer control over those claims to committees of attorneys. It establishes a complex allocation formula to distribute recoveries, settlements and other funds to such parties and their attorneys.

The Sharing Agreement provides that other FTC creditors and security holders can also enter into the agreement upon request and upon assigning their claims to the pool.

However, the agreement by its terms excludes certain FTC creditors and shareholders (including Outside Directors) from participation. It expressly excludes as *creditors*:

> all present or former officers, directors, accountants or attorneys of FTC, or underwriters of FTC securities, together with their present or former spouses, members of immediate families, next-of-kin or assigns, or any entity in which any of said persons has a controlling interest, including without limitation all of such PERSONS presently named as defendants in the CONSOLIDATED COMPLAINT . . . .

Sharing Agreement A(21).

It also expressly excludes all *shareholders* who are:

> defendants named in the CONSOLIDATED ACTION, all members of the immediate families of any individuals named as defendants therein, or of any other individuals excluded from the class defined therein, all partners, officers, and/or directors of any entities named as defendants therein, or of any other entities excluded from the class defined therein, all entities in which any defendant, or any other individual or entity excluded from the class defined therein, has a controlling interest; all PERSONS who purchased or otherwise own any FTC securities on behalf of any defendant therein; or any other individual or entity excluded from the class defined therein; and all other individuals or entities found culpable of wrongdoing in the CONSOLIDATED ACTION or any related action.

Sharing Agreement A(5).[1]

1. Discovery (occurring after the Eighth Circuit opinion below) sheds light on why different exclusory language is used for creditors than for security holders. Two of the four creditors that drafted and signed the Sharing Agreement are Northwestern National Bank of Minneapolis (now Norwest Bank Minneapolis) and Fifth Northwestern National Bank of Minneapolis, (now Norwest Bank Calhoun-Isles) affiliated banks represented by the same counsel ("Northwestern" and "Fifth").

In November of 1981, over six months before the final FTC securities offerings, Northwestern sent a team of auditors to review FTC. The auditors wrote a fourteen-page internal memorandum exposing many of FTC's improprieties which are now the basis for claims in the civil actions. They concluded FTC was unable or unwilling to provide requested records. They disclosed that FTC's aircraft usage averaged only some 17 hours per month, not over 40 hours per month as represented in the 1981 securities offering prospectus. They reported that FTC was expensing only 20% of the cost of large group charters, and that FTC's controller justified this by claiming FTC received rebates from hotels on the expenses not booked. They reported that FTC's president denied the controller's explanation, and they concluded that this accounting practice "obviously vastly inflates the income for this company." They reported that "[a] statement made in the company's 10-Q [a public report filed with the SEC] for the quarter ended 9/30/81 also appears to be misleading" because it attributed increased revenues to increases in utilization of FTC's aircraft. The auditors listed numerous other discrepancies and concluded that Northwestern Bank should not extend credit beyond its existing line and should get its loans paid off as soon as possible.

Northwestern Bank then threatened to declare FTC in default. However, in March 1984, the bank and FTC deleted the provision by which FTC was in default, accelerated the due date of the loans, agreed the loans would be paid off at the time of the planned public offerings, and agreed that Northwestern must approve the language in the offering prospectuses about the credit lines. Neither Northwestern, Fifth, nor FTC disclosed these obviously material developments to anyone. Thus new creditors were found, Northwestern was paid off millions of dollars, and the 1984 offerings were completed.

The broad shareholder exclusionary language in the Sharing Agreement ("all other . . . entities found culpable of wrongdoing in . . . any related action . . . ") would likely exclude Northwestern and Fifth, but they have no claims as shareholders. The language for creditors applies only to " . . . officers, directors, accountants or attorneys of FTC, or underwriters of FTC securities . . . " and thus appears not to exclude Northwestern and Fifth.

Thus the Sharing Agreement excludes the cross-petitioners simply on the basis of their status as defendants, from participation in the agreement. Of course, no one could object to a group of claimants agreeing to cooperate, and to exclude others, but in the present case, the FTC Receiver also entered the Sharing Agreement.

Under the Sharing Agreement as now drafted, the FTC estate transfers *all* its assets and claims into the Sharing Agreement pool. Sharing Agreement ¶¶ A(3) and A(30). The FTC Receiver assigns away his control over all FTC's assets and claims to a committee of attorneys. Sharing Agreement ¶ A(4) and B(1) through B(7). The bankruptcy estate of FTC, under the Sharing Agreement, is controlled not by the Receiver, but by a group of attorneys representing *some* FTC creditors and *some* FTC shareholders. This favored group controls the pursuit of FTC claims and the distribution of FTC assets, functions assigned by law to the Receiver as FTC's debtor-in-possession. Some or all of the cross-petitioners are excluded from this favored group.

On July 20, 1983, the District Court filed three orders. One certified plaintiff classes in security purchasers' lawsuits (Pretrial Order #153), one approved the Sharing Agreement as a fair, reasonable and adequate settlement (Pretrial Order #154), and one authorized the Receiver, as debtor-in-possession of FTC, to become a party to the Sharing Agreement and bind the FTC estate to its terms (the "Bankruptcy Order").

Court of Appeals Proceedings.

On March 26, 1984, the Eighth Circuit Court of Appeals affirmed the judgment of the district court in part and vacated in part. First, the court of appeals ruled that the Sharing Agreement did not amount to a *de facto* plan for the reorganization of FTC, but instead was more like a compromise or settlement. The Court of Appeals thus allowed the FTC estate to transfer all its assets and claims to a self-selected group of claimants and transfer control of the estate

to such claimants without complying with the relevant bankruptcy provisions. The Court of Appeals justified the arrangement because at some later date the estate would receive back an allocation according to a formula set forth in the Sharing Agreement, and could *then* follow bankruptcy procedures to distribute its allocation.

Next, the Court of Appeals held that the substantive terms of the Sharing Agreement were fair to the extent they compromised a dispute between the FTC estate and the 1982 securities purchasers over an "Escrow Fund" holding proceeds of the 1982 public offering.

Finally, the Court of Appeals held that the Sharing Agreement could not exclude claimants such as Outside Directors from participating in the FTC estate simply because they were named as defendants in lawsuits. The court's conclusion was proper, but the court failed to properly implement it. It proposed a minor modification to the formula governing what the estate would receive in the future, but it still allowed the Receiver to transfer *all* the estate's assets and to abdicate control over the marshalling and distribution of those assets. Excluded claimants are left with claims against an estate with no assets. They are left merely with a claim for their share of a promised future allocation to the estate to be made by a preferred, self-selected group of claimants.

The Eighth Circuit denied on May 25, 1984, a petition for rehearing *en banc*. Reavis & McGrath petitioned this court to grant a writ of certiorari on July 24, 1984. The time for all respondents to file papers was extended to October 8, 1984 by the Clerk of the Supreme Court. This response and cross-petition is filed in response to the Reavis & McGrath petition. Cross-petitioners respectfully request that this cross-petition be considered irrespective of the disposition of the Reavis & McGrath petition.

REASONS FOR GRANTING THE WRIT

I. THE EIGHTH CIRCUIT PROPERLY CONCLUDED THAT CROSS-PETITIONERS CANNOT BE EXCLUDED FROM EQUAL PARTICIPATION IN THE FTC BANKRUPTCY, BUT THEN ERRED BY EXCLUDING THEM FROM EQUAL PARTICIPATION.

The Eighth Circuit Properly Concluded that Cross-petitioners Cannot Be Excluded from Equal Participation in the FTC Bankruptcy.

Discriminatory treatment of cross-petitioners and other disfavored claimants violates the tenets of the Bankruptcy Code and the requirements of due process of law. The Eighth Circuit Court of Appeals acknowledged that the cross-petitioners cannot be excluded altogether from participation in recoveries on FTC claims "simply because they have been named as defendants in suits brought as a result of the FTC debacle." The Court of Appeals continued: "we know nothing of the merits of any of the claims made by the 'outside' directors, to take one example." Thus the Court of Appeals was not able to "weigh the respective merits of each side of the legal dispute and decide whether the settlement was fair and reasonable in view of the likelihood of either side's success." The Court of Appeals continued:

> If a non-management director of FTC, to take one instance as an illustration, is wrongly accused of wrongdoing and is ultimately vindicated, and if the by-laws of FTC provide that such a director is entitled to indemnification for the costs and expenses of unsuccessful suit against him, we see no reason, at least so far as the record has been developed to date, why his claim for indemnity should be *a priori* treated differently from, and less advantageously than, the claims of other creditors of FTC.

Of course, the principles of equitable subordination, now codified in 11 U.S.C. § 510(c) (1982), will continue to apply, and the bankruptcy court is free, in later proceedings, to determine upon a proper record that the claims of particular defendants should be subordinated to the claims of other creditors. See, *e.g.*, *Pepper* v. *Litton*, 308 U.S. 295 (1939); *Farmers Bank* v. *Julian*, 383 F.2d 314, 322-23 (8th Cir.), *cert. denied*, 389 U.S. 1021 (1967).

The Eighth Circuit's Conclusion that Cross-Petitioners Cannot be Excluded from Equal Participation in the FTC Bankruptcy is Supported by Bankruptcy Law and Due Process Requirements.

The Eighth Circuit Court of Appeals concluded that cross-petitioners cannot be excluded from equal participation, but it did not articulate the reason. Both bankruptcy law and due process require such a conclusion.

The Bankruptcy Code, Section 1123(a)(4) provides that a Chapter 11 plan must "provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interests." 11 U.S.C. § 1123(a)(4). Collier notes that this section "restates a cardinal principle of bankruptcy practice, namely that creditors of the same class have a right to equality of treatment." *Collier on Bankruptcy*, 15th ed., § 1123.01(4).

Matter of Mobile Steel Co., 563 F.2d 692 (5th Cir. 1977) is an example of the application of these principles. The bankruptcy judge, after full hearings, disallowed certain claims of officers and directors of a bankrupt corporation and subordinated others. The Court of Appeals reviewed in detail the facts relating to each questioned claim in light of the legal principles of equitable subordination and of the appropriate pleadings and burdens of proof. Noting that claims could not be invalidated "simply because of the nature of the relationship existing between the claimant and the bankrupt," the

Court of Appeals reversed, holding that subordination and disallowance were not proper. The cross-petitioners in the case at bar are entitled to a similarly careful review of their claims before they can be placed in an inferior position.

Even if the FTC bankruptcy is converted to a Chapter 7 liquidation, the same principles will apply. The proper categorization of claims would then be set forth in 11 U.S.C. § 726. Section 726(b) essentially provides for pro rata treatment of claims within each class.

Due process requirements of the Fifth Amendment also require that claimants obtain a proper notice and hearing of their claims. In the FTC litigation there has been notice and a hearing with respect to the Sharing Agreement, but not with respect to the specific claims of cross-petitioners. See *New York* v. *N.Y., N.H. & H. Ry. Co*, 344 U.S. 293 (1952); *In re Intaco Puerto Rico, Inc.*, 494 F.2d 94 (15 Cir. 1974); *In re AOV Industries, et al.*, 31 B.R. 1005 (D.C.D.C. 1983).

The Eighth Circuit Erred by Failing to Apply to the FTC Litigation the Principles it Acknowledged.

The Eighth Circuit Court of Appeals failed to apply the principles it acknowledged, because it would allow the FTC estate, pursuant to the Sharing Agreement, to be divided by and among certain claimants while excluding other claimants.

The Sharing Agreement establishes a complex fund distribution system. All funds collected, whether from the FTC estate's assets or claims, or from other parties' claims, are held until a certain dollar amount is reached. This amount is then initially divided between creditors and security holders. Specifically, of the first \$25 million, only \$11 million goes to creditors. Of the next \$5 million, only \$1.5 million goes to creditors. Of the next \$5 million, only \$1.8 million goes to creditors. Additional recoveries are also divided by a predetermined formula. Given the size of the FTC estate (approximately \$28 million) it is inevitable that at some point in the allocation scheme, funds coming from the FTC estate will be allocated to security holders.

The security holders' allocation is further divided into subclasses. One of the subclasses of security holders includes all persons buying FTC securities between November 30, 1979, and June 18, 1982. Some of the cross-petitioners purchased FTC stock and would be included in this category but for the exclusionary language quoted above. Thus, these claimants are placed in an inferior position with respect to their bankruptcy claims against assets of the FTC estate. While other security holders participate in sharing these funds from the estate, cross-petitioners are precluded from participation. Furthermore, to the extent the FTC estate's assets are allocated to security holders, cross-petitioners' claims as creditors also are effectively subordinated to shareholder claims.

The creditors' allocation under the Sharing Agreement is subdivided into Fund A and Fund B. Fund A is the portion of the allocation to creditors the source of which is assets or claims of the FTC estate. Fund B is moneys from which Outside Directors are excluded. "PARTICIPATING CREDITORS" are entitled to submit claims against both Fund A and Fund B. "CREDITORS" who are not "PARTICIPATING CREDITORS" (*e.g.*, Outside Directors) can only participate in Fund A.[2] The determination of how much of the estate's assets goes into Fund A depends in part on how much of the estate's assets went to security holders in the first allocation between security holders and creditors. These decisions are not made by the Receiver, but by the committees of attorneys representing certain claimants (and excluding Outside Directors).

The FTC estate also includes claims against others. Under the Sharing Agreement the management of these claims and the determination of how much the estate receives is not controlled by the Receiver. For example, the FTC

2. Because of the differences between exclusionary language for creditors and for shareholders, Northwest and Fifth, referred to in note 1 above, can claim against both funds, even though leave of court has been sought to assert claims against them in several FTC-related actions.

estate has potential claims against its outside legal counsel. Other parties to the Sharing Agreement also have claims against the outside counsel. Under the Sharing Agreement all such claims would be settled at the same time. If such defendant were to settle with the Sharing Agreement participants, the participants would then determine how to allocate the funds. The allocation cannot be made until it is determined how much of the settlement should be treated as resulting from FTC's claim, and how much from other claims. This decision would *not* be made by FTC's Receiver. Again, unless the Supreme Court grants this cross-petition, a self-selected group of claimants and not the Receiver will effectively determine the scope of FTC assets. The amount determined to result from FTC's claim then might be divided between creditors and security holders. If such money is allocated to security holders, cross-petitioners' claims — even their creditors' claims — will be effectively subordinated to shareholder claims.

The Sharing Agreement empowers the Sharing Agreement committees to make these decisions. To the extent all money from a particular defendant, up to the amount of FTC's claims against that defendant, does not go into Fund A, these committees will be effecting *de facto* subordinations of cross-petitioners' bankruptcy claims. These *de facto* subordinations will occur without a determination of whether such claims should be subordinated under bankruptcy laws, and without any determination of the merits of cross-petitioners' claims. This would contradict the procedural and substantive bankruptcy requirements for dealing with claims, and would be a denial of due process.

II. THE SHARING AGREEMENT IS A *DE FACTO* PLAN OF REORGANIZATION AND THE EIGHTH CIRCUIT ERRED BY APPROVING IT WITHOUT COMPLIANCE WITH THE REQUIREMENTS OF THE BANKRUPTCY CODE.

By entering the Sharing Agreement the FTC bankruptcy estate has agreed to transfer all assets and claims and control

over all assets and claims to some, but not all persons asserting claims against the estate. This constitutes a plan of reorganization and cannot be approved until all the requirements of the Bankruptcy Code are met. There was no attempt to comply with any of the bankruptcy law provisions in entering the Sharing Agreement.

The Eighth Circuit Court of Appeals held that the Sharing Agreement is not a plan of reorganization and need not comply with the requirements of Chapter 11 of the Bankruptcy Code. This holding directly conflicts with the Second Circuit's decision in *In Re The Lionel Corporation*, 722 F.2d 1063 (2d Cir. 1983), and the Fifth Circuit's decision in *In Re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983), both of which held that the express requirements of Chapter 11 must be followed whenever the estate seeks to dispose of an important asset. The Eighth Circuit's decision, if permitted to stand, would eviscerate the procedural and substantive protections of Chapter 11.

The petitioner Reavis & McGrath presented this argument in Section I of its petition. This response and cross-petition incorporates such argument and supplements it as follows.

On June 20, 1982, certain creditors filed an involuntary petition under Chapter 11 of the Bankruptcy Code. The bankruptcy judge granted the involuntary petition on May 18, 1983, entering an order for relief under 11 U.S.C. § 303(h). The entry of that order created an estate consisting of all legal or equitable interests of FTC, all property recovered for FTC under certain voiding powers and other property. 11 U.S.C. § 541. However, the bankruptcy judge continued an earlier order suspending the operation of 11 U.S.C. § 543(a) and (b), thereby leaving possession of the property in the hands of the Receiver previously appointed by the District Court.

Because of the pending Chapter 11 case and the creation of the estate, the reorganization (liquidation is a form of

reorganization) of FTC must be done in compliance with the provisions of the Bankruptcy Code. These provisions require that a reorganization (even a liquidating reorganization) be accomplished through a plan accepted by the creditors and confirmed by the Court after compliance with important procedures.

The Sharing Agreement, on the other hand, transfers all of the assets of the FTC estate to third parties and empowers the third parties to distribute the liquidated proceeds of the assets to some but not all claimants. If the Receiver's attempt to enter the Sharing Agreement is valid, the FTC estate has given up all assets and all rights to negotiate and settle claims. Those rights are now controlled by committees of attorneys for *some* shareholders (excluding Outside Directors) and *some* creditors (excluding Outside Directors). These committees and not the Receiver will determine what constitutes claims of the estate. They will determine which claims will be pursued and how they will be pursued. All such committee members have interests that conflict with interests of the estate. They all have incentive to minimize the assets of the estate by diverting estate funds directly to themselves through the Sharing Agreement.

The Sharing Agreement contains provisions designed to marshall, consolidate, administer and distribute all of the FTC assets. It contains voting procedures for certain groups of FTC claimants, provides for assignment of duties with respect to the continued prosecution and settlement of FTC's claims, and establishes bank accounts for the payment of fees and expenses and for the allocation of proceeds of FTC's recoveries to creditors and security holders. All these functions are performed by third party committees. In short, notwithstanding the fact that the Sharing Agreement is denominated a "Sharing Agreement," it is, in fact and substance, a plan for the liquidating reorganization of FTC.

The Sharing Agreement is deficient as a plan for many reasons. It was not negotiated by a court-appointed "creditors committee" in accordance with 11 U.S.C. § 1102(a)(1). It

is a vital function of such a creditors committee to be "the primary negotiating [body] for the formulation of the plan of reorganization." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 401 (1977). Section 1103(c)(3) specifically grants to such a committee the power to participate in and recommend any reorganization plan. While the Sharing Agreement does provide for a "CLAIMANTS' COMMITTEE", that Committee bears no relation whatsoever to a Chapter 11 creditors' committee. The CLAIMANTS' COMMITTEE has not been appointed by the Court and does not consist of those persons holding the seven largest claims, as is generally required by § 1102. A true creditors committee under the Bankruptcy Code was later appointed by the District Court, but only after the Sharing Agreement had been signed and presented to the District Court.

The Sharing Agreement fails other requirements of Chapter 11. A plan must designate all classes of claims or interests, specifying each unimpaired class under the plan and the treatment of any class that is impaired under the plan. 11 U.S.C. § 1123. This has never been done.

The Sharing Agreement fails to provide for acceptance or rejection of the plan by holders of claims and interests in the plan, and by classes of such claims. A class of claims has accepted a plan when the plan has been accepted by creditors holding "at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors that have accepted the plan." 11 U.S.C. § 1126(b).

The Sharing Agreement fails to comply with confirmation provisions of a plan. Confirmation of a plan requires that with respect to each class, each holder of a claim of such class has either accepted the plan or received an amount that is not less than such holder would have received had the debtor been liquidated under Chapter 7. The Sharing Agreement's voting provisions for the classes and sub-classes neither recognize nor adhere to these requirements of Chapter 11.

The acceptance of a plan may not be solicited until a disclosure statement containing the information required in 11 U.S.C. § 1125 is filed and approved by the court. Thereafter the disclosure statement is transmitted to the holders of claims and interests in advance of their vote on the plan. There is no disclosure statement in this case.

Another element in the confirmation of a plan is the requirement that a plan be "fair and equitable"; the plan must either provide that each holder of a claim receive the full amount of his claim or that the holder of any junior claim will not receive any property on account of such junior claim. § 1129(b)(2)(B)(ii). In adopting Section 1129, both the House and the Senate noted that:

> In the event [the common stock has] no fixed liquidation preference or redemption price, then the plan may be confirmed as long as it provides the holders of such interests property of a present value equal to the value of such interests. If the interests are "under water" i.e., the debtor is insolvent, then they will be valueless and the plan may be confirmed notwithstanding the dissent of that class of interests even if the plan provides that the holders of such interest will not receive any property on account of such interests. [Statement of Legislative Leaders (House), 124 Cong. Rec. H. 11087, 11104-5 (daily ed. Sept. 28, 1978); (Senate) 124 Cong. Rec. S 17417, 17421 (daily ed. Oct. 6, 1978)].

Congress, in promulgating Section 1129, recognized that in cases of insolvent corporations, common stockholders would receive nothing, and in all other instances, those stockholders would remain junior to creditors. This is directly in line with the case law preceding the Bankruptcy Reform Act of 1978. In *TMT Trailer Ferry* v. *Anderson*, 390 U.S. 414, 441 (1968), for example, the Supreme Court stated that:

> [A] bankruptcy court is not to approve or confirm a plan of reorganization unless it is found to be 'fair

> and equitable.' This standard incorporates the absolute priority doctrine under which creditors and stockholders may participate only in accordance with their respective priorities, and 'in any plan of corporate reorganization unsecured creditors are entitled to priority over stockholders to the full extent of their debts. . .' [citation omitted]

The rule, denominated by the courts as the "absolute priority doctrine," has been applied not only in those cases where the common stockholders have sought recovery prior to creditors and debt holders for the value of their equity, but even where the stockholders have based their claims on allegations of fraud. *See, e.g., Scott* v. *Abbott*, 160 F. at 582; *Carter* v. *Bogden*, 13 F.2d 90 (8th Cir. 1926); *Matter of Stirling Homex Corp.*, 579 F.2d 206 (2d Cir. 1978), *cert. denied sub nom, Jezarian* v. *Raichle*, 439 U.S. 1074 (1979); *In re U.S. Financial Inc.*, 648 F.2d 515 (9th Cir. 1980), *cert. denied sub nom, Kelce* v. *U.S. Financial Inc.*, 451 U.S. 970 (1981). As early as 1896, the Eighth Circuit Court of Appeals cautioned against stockholder parity with creditors:

> When a corporation becomes bankrupt, the temptation to lay aside the garb of a stockholder, on one pretense or another, and to assume the role of a creditor, is very strong, and all attempts of that kind should be viewed with suspicion.

Newton Nat. Bank v. *Newbegin*, 74 F. 135, 140 (8th Cir. 1896).

This approach to shareholders' claims based on fraud has been codified in the Bankruptcy Reform Act of 1978 as Section 510(b), which provides that:

> Any claim for rescission of a purchase or sale of a security of the debtor or of an affiliate or for damages arising from the purchase or sale of such a security shall be subordinated for purposes of distribution to all claims and interests that are senior or

equal to the claim or interest represented by such security.

In promulgating Section 510(b), both houses of Congress noted the impact of the section on common stockholders: "If the security is an equity security, the damages or rescission claim is subordinated to all creditors and treated the same as equity security itself." H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 359 (1977); S. Rep. No. 95-989, 95th Cong., 2d Sess. 74 (1978).

It is thus clear that Sections 510(b) and 1129, as well as the prior case law, require that for a plan to be confirmed as "fair and equitable", the plan must not recognize the claims of common stockholders before those of creditors. Accordingly, in allocating payment of funds to the holders of FTC common stock, the Agreement is fatally flawed in that it allows junior claims or interests to be paid before the other creditors, in contravention of Sections 510(b) and 1129.

These are a few of the ways in which the Sharing Agreement, as a plan of reorganization, fails to comply with the requirements of Chapter 11. If the Sharing Agreement is upheld, the Chapter 11 debtor will have been liquidated and a scheme of distribution to creditors, which scheme is different than that provided in either Chapter 7 or Chapter 11 of the Bankruptcy Code, will have been imposed in total disregard of bankruptcy law.

Furthermore, the orders of the District Court authorize and direct the receiver to take action which violates his fiduciary and statutory duties. The Receiver was appointed the debtor-in-possession in the Chapter 11 bankruptcy. The debtor-in-possession has the rights, powers, and duties specified in 11 U.S.C. § 1107. That section provides, subject to some limitations, that the debtor-in-possession has the powers of a trustee as set forth in 11 U.S.C. §§ 1106 and 704.

A trustee serves as a representative of the creditors and his duties in this respect are succinctly outlined in *Collier on*

Bankruptcy (14th Ed.), *Trustees and Receivers' Handbook* § 7.001, p. 222:

> *The trustee is the statutory representative of all the creditors*, and he holds the assets of the estate in trust for their benefit. *He represents all creditors, not only the majority*, however great that may be. He must be an impartial administrator whose duty is to administer the estate for the benefit of each and every one of the creditors.
>
> * * *
>
> The trustee's office is one of personal confidence, and the duties imposed upon him are his and his alone. *He cannot delegate his duties to others*, and ultimately he is responsible for all actions taken during the administration of the estate which affect the interest of creditors. Moreover, he is responsible for actions not taken when they are called for. (emphasis added)

The trustee is generally recognized as an officer of the Court. The title of trustee has "fiduciary significance in the equity sense." 2 *Remington on Bankruptcy* § 1117, p. 580 (1956). In such a capacity, it necessarily follows that the trustee may not be the representative of any particular creditor, but must represent all creditors without partiality. In *re Lewensohn*, 121 F. 2d 538, 539 (2nd Cir. 1903) and *Matter of Russo*, 18 B.R. 257 (Bankr., E.D.N.Y. 1982).

The FTC Receiver, by participating in the preparation of the Sharing Agreement, and by attempting to transfer all assets and claims of the estate to the Sharing Agreement, favored the desires of *some* of the claimants to the prejudice of other claimants.

Another duty imposed upon a trustee under 11 U.S.C. § 1106(a)(5) of the Bankruptcy Code is to file a plan, or file a report of why the trustee will not file a plan, or recommend conversion of the case to a case under Chapter 7 or 13 or

dismissal of the case. The Sharing Agreement constitutes a plan but was not filed as such. The Receiver thus has failed to exercise these duties. Also the Sharing Agreement must be invalidated in these circumstances.

III. THE DISTRICT COURT ABDICATED ITS RESPONSIBILITY TO PREPARE FINDINGS OF FACT AND CONCLUSIONS OF LAW SETTING FORTH THE BASES FOR ITS DECISION TO APPROVE THE SHARING AGREEMENT

Respondents/cross-petitioners agree and support Reavis & McGrath's petition for certiorari with respect to Question Number 3 presented by them. Such question and the Argument in support of such question are incorporated herein by reference.

REASONS WHY THE WRIT SHOULD BE DENIED WITH RESPECT TO QUESTION NUMBER 2 SUBMITTED BY REAVIS & McGRATH

SECURITY HOLDERS CANNOT BYPASS THEIR SUBORDINATE POSITION WITH RESPECT TO CREDITORS BY ASSERTING THEY WERE DEFRAUDED IN CONNECTION WITH THEIR PURCHASE OF SECURITIES.

Reavis & McGrath argues (in Section II of its petition) with respect to Question Number 2 of its petition that the money paid by security purchasers and received by FTC for securities it sold to them in the 1982 offerings should not have been determined to be part of the FTC estate.

To return these funds to purchasers of securities, as Reavis & McGrath proposes, would give shareholders preference over creditors in the FTC bankruptcy in violation of the bankruptcy provisions.

Section II above under "Reasons for Granting the Writ" discusses the absolute priority doctrine, which requires that

shareholders' claims be subordinated, even where shareholders claim to have been fraudulently induced to purchase their shares. Such section also points out the language of Section 510(b) of the Bankruptcy Reform Act of 1978, clearly prohibiting security holders from avoiding their subordinate position through claims based on fraud.

The Court should refuse to grant a writ with respect to Question Number 2 of Reavis & McGrath.

CONCLUSION

For the above reasons, respondents/cross-petitioners respectfully request that Reavis & McGrath's petition be granted with respect to Questions 1 and 3 presented by it and that its petition be denied with respect to Question 2. Respondents/cross-petitioners also request that this cross-petition for certiorari be granted.

Respectfully submitted,

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